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BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

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Chairman Davis, Congressman Waxman, and Members of the Committee, I appreciate the opportunity to appear before you today to discuss the Committee's current plans for the "Services Acquisition Reform Act of 2003" (SARA). Service contracting represents an ever-increasing proportion of our procurement budget, as agencies look to the commercial marketplace for managed solutions to address their varied needs. We must find ways to ensure our officials are effectively positioned within their agencies to manage the acquisition process, our contactors are offered the type of incentives that will motivate them to perform at their best, and our taxpayers are able to reap the full benefit of the marketplace's ingenuity. I thank the Committee for engaging the Administration in productive dialogue to address these important challenges.

For our part, the Office of Federal Procurement Policy (OFPP) is pursuing a variety of initiatives to lower costs and improve program performance to citizens. These activities include:

- Establishing the Federal Acquisition Council (FAC), a senior level forum of acquisition officials to promote effective business practices for the timely delivery of best value goods and services to the agencies. Working closely with OFPP and

the Federal Acquisition Regulatory Council, the FAC will ensure each agency is committed and engaged at the highest levels in furthering the priorities of the President's Management Agenda.

- Strengthening the use of competition in our everyday acquisitions for services. Proposed changes to the Federal Acquisition Regulation (FAR), published in the Federal Register earlier this month, will improve application of acquisition basics in purchases for services from the Multiple Award Schedules (MAS) program, just as changes published last summer have laid a foundation for improved ordering from multiple award contracts.

- Revitalizing the use of performance-based services acquisitions (PBSAs) to capitalize on contractor innovation in meeting the government's needs. An OFPP-sponsored inter-agency group is working to make PBSA policies and procedures more flexible and easier to apply.

- Reducing transaction costs and increasing transparency through technological advances. We are seeking to capitalize on the efficiency, transparency, and administrative simplification that technology enables to stimulate the type of robust contractor participation that makes for a successful virtual marketplace.

- Promoting more accountable and strategic management to preserve current flexibilities. We are pushing agencies to improve oversight over their purchase cards and track buying behaviors of their employees so they can realize cost-savings efficiencies in acquisition and finance operations without wasting hard-earned taxpayer dollars.

In pursuing these and other initiatives, I have sought to take advantage of existing statutory authorities under a framework that has been shaped over the past decade through the leadership of this Committee. I believe there is more that can, and should, be done within this framework to improve acquisition practices. For this reason, I have not actively sought significant statutory change during my tenure as Administrator. At the same time, I recognize that carefully tailored legislative provisions can complement the Administration's efforts to achieve greater return on our investment of federal resources.

This morning, I would like to offer some general observations on possible legislative actions that I understand the Committee is considering for SARA. I have organized my comments around three themes: (1) strengthening the management of the

procurement process, (2) improving use of contract incentives, and (3) taking greater advantage of the commercial marketplace. These themes were prominent in SARA when the bill was first introduced in the last session of Congress, as H.R. 3832, and I understand they will form the backbone of the new bill. As you will hear, I think there are a number of concepts that can form the core for meaningful legislation.

I should make one caveat at the outset of my statement. The comments that follow are based on a discussion I had with your staff, who recently met with me to describe the Committee's current thinking for SARA. Because agencies were not privy to this conversation, my statement does not reflect the benefit of their full insight. Of course, after SARA is introduced, the Administration will be able to offer more formal views to help inform your thinking as Congress considers the bill. With this proviso in mind, let me now share some preliminary thoughts.

Management of the Procurement Process

As one major goal, SARA would seek to improve the overall management of the procurement process. Among other things, the new bill would align management structures to better reflect the integrated nature of acquisitions and require studies to identify opportunities for further improvements. In my opinion, both of these endeavors have merit.

Increasing the emphasis on the integrated nature of acquisition. As I understand, the Committee intends to propose a variety of provisions for SARA to increase attention on the fact that acquisition is an integrated activity. For example, the bill would codify a standard definition of the term "acquisition" that captures the full cycle of activities, from

requirements development to contract financing and contract administration. The bill would further require that each executive agency appoint a "chief acquisition officer" (CAO) who would be responsible both for traditional procurement oversight, such as increasing use of full and open competition, as well as for acquisition management. In addition, the bill would establish a CAO Council to monitor and improve the federal acquisition system.

I share the Committee's desire to foster better integration between traditional contracting functions and related disciplines whose input is critical to successful acquisition. The Administration is finding many benefits in being more mindful of the relationships between the functions that make up the acquisition process. As a general matter, under OMB's capital programming guidance (in Circular A-11, Part 7), agencies must prepare business cases for major capital acquisitions to justify their requests for budget. Business cases must be reviewed in the agency by an executive committee composed of the senior program official, the Chief Financial Officer, the Chief Information Officer, and the senior procurement executive. This senior level review ensures that investments reflect the true needs of all stakeholders to the acquisition process -- not just one vested interest. This process is helping us to identify projects at risk and avoid wasteful duplication of expenditure.

You might also note that in our efforts to carry out the President's vision of a citizen-centric e-Government for acquisition, we have been reshaping information technology (IT) investments in ways that mirror the integrated nature of acquisition. This focus is enabling us to facilitate the migration and leveraging of IT investments to modernized, technology-based infrastructures that harmonize the varying functions that

support the acquisition process. Managers across agencies have greater awareness of the activities of their counterparts and, as a result, are in a better position to identify and avoid redundant IT investments. This awareness saves money for the government and can reduce burdens on contractors as well. Creating a government-wide integrated "business partners network," for instance, means that contractors may register once to do business with the government and avoid having to make costly redundant submissions, as they have been required to do in the past. Accurate and up-to-date registration information also promotes timely payment to contractors.

For these reasons, I think there is benefit in several of the steps the Committee is considering to ensure acquisition is approached as a shared responsibility. First, I agree with the Committee's recommendation to codify the definition of "acquisition." Having a statutory definition that captures an integrated vision of the entire spectrum of acquisition will serve as a useful reminder to the community at large that acquisition requires not only the expertise of contracting officials, but also the active participation of program, IT, and finance functions, among others.

Second, I agree with the Committee that senior level commitment to integration is needed if this vision is to be institutionalized across government. In this regard, the creation of a CAO to effectively oversee these integrated activities may be beneficial. OMB would envision that these appointments be accomplished through use of existing resources.

In the past, when I testified before the Technology and Procurement Policy Subcommittee (TAPPS), I suggested that creation of a CAO not come at the expense of committed attention on traditional procurement activities. There remains a very real

ongoing need for attention to the nuts and bolts of contracting -- what I have referred to as "acquisition basics." At the same time, I am increasingly confident that agencies will take the steps necessary to ensure this commitment is fulfilled by CAOs. This confidence is a reflection, in large part, of the progress the Administration has been making to create a performance-based government. The Program Assessment Rating Tool (PART), for example, is laying the foundation for evidence-based funding decisions. In addition, the use of precise action plans on what agencies must deliver, and "traffic light" scorecards to grade progress on priorities, are making the government answerable to the public for results. As these accountability mechanisms take hold, agencies will continue to adjust their management structures, including those related to contracting activities, to ensure effective return on taxpayer investment.

As the bill moves forward, I would suggest that the Committee consider making the appointment of CAOs optional for small agencies with minimal procurement budgets -- e.g., generally agencies that are not members of the President's Management Council (PMC). Such a mandate may be constraining for these agencies.

Third, I strongly support the statutory recognition of a CAO Council and commend the Committee for considering such a provision for its bill. Progress often requires sustained effort, and a properly focused senior-level organization can play a vital role in delivering the type of ongoing agency commitment required for achieving real results. This reasoning recently led the Administration to establish the FAC. The FAC's charter makes clear that agency efforts are to be effectively aligned with the President's Management Agenda and other priority acquisition initiatives. Consistent with the President's vision for a market-based government, the Council will emphasize initiatives

that promote competition, transparency, fairness, integrity, and openness in the federal acquisition process.

OMB has high expectations for the new Council. The PMC worked closely with us in creating a membership that would help deliver results and we would anticipate similar consultation regarding representation on a statutory council.

Studying opportunities for further improvement. SARA would require OFPP to establish an advisory panel to review laws and regulations that hinder the use of commercial practices, performance-based contracting, the performance of acquisition functions across agency lines of responsibility, and the use of government-wide acquisition contracts. OFPP would report to Congress approximately 15 months after SARA is enacted.

I appreciate the benefit that may derive from studying these areas. My office would certainly want to be an active participant in such reviews. However, current funding constraints would significantly limit OFPP's ability to effectively lead an effort of this magnitude. I hope the Committee will take this point into consideration so that a review of these issues receives the level of attention needed to generate the type of meaningful analysis that can form the basis for additional improvements.

Contract incentives

As a second goal, SARA would include various provisions to encourage good contract performance. The new bill would provide motivation for agencies to use PBSA, codify use of award-term contracting, expand application of share-in-savings contracting,

and facilitate telecommuting by federal contractors. With a few caveats, these are generally positive steps.

Reinvigorating PBSA. I support efforts to reinvigorate the use of PBSA and take advantage of the innovativeness that is generated when contractors are given the freedom to figure out the best solution to meet the government's needs. An OFPP-sponsored working group is helping to lay the foundation for improved FAR coverage and new practical guidance, such as sample performance-based statements of work. OFPP intends to review data collected by the Federal Procurement Data System (FPDS) to measure PBSA usage. FPDS began collecting data in FY 2001 on whether service contracts are performance-based. This measure will not, by itself, indicate the effectiveness of PBSA. However, the measure will serve as a useful gauge of whether agencies are making PBSA a priority.

SARA would complement these activities by authorizing agencies that apply this concept, and meet certain other conditions, to conduct their acquisitions under FAR Part 12, which is otherwise reserved for commercial item purchases. I support this type of incentive, which builds on a concept first sanctioned by Congress in the FY 01 Defense Authorization Act. The Defense Authorization Act allowed DOD, on a trial basis, to take advantage of Part 12 for PBSA acquisitions that, among other things: (1) were in amounts up to $5 million, and (2) were placed on a firm-fixed price basis. I understand the Committee proposes permanent authority and the elimination of limitations on both contract type and dollar size of the acquisition.

I recognize that there may be benefit in some broadening of the authority afforded to DOD. However, I would want to ensure, at a minimum, that purchases are not made

using cost-type contracts. This limitation serves as a needed safeguard when conducting a purchase using the tools of FAR Part 12, which were geared towards arrangements that provide for tangible results. I also think that, at this point in our transition to PBSA, where we are seeking to gain experience and develop expertise, pilot authority is probably preferable to permanent authority. Pilot authority gives us the opportunity to compare the gains made through the use of PBSA to any potential negative consequences of purchasing non-commercial items under a framework designed for services that have been market tested or have commercial analogs. I would have no objection to a long-term pilot or to significantly increasing the size of eligible acquisitions.

I understand the bill would require OFPP to establish a center of excellence in contracting for services. The center would serve as a clearinghouse for identifying and promoting best practices. While the idea is a sensible one, OFPP may be hard-pressed to effectively lead such an initiative under current funding constraints.

Using award-term contracts. The bill would include a provision allowing an agency to extend a contract by one or more additional periods on the basis of exceptional performance by the contractor. A contract providing for such extension would be required to include performance standards and be performance-based to the maximum extent practicable.

There is intuitive appeal to "award-term" contracting where contractors are offered the opportunity to obtain more work as a mechanism for motivating exceptional performance. This commercial-style practice may create a win-win situation for the government and contractors alike if agencies are vigilant about: (1) conducting new competitions when cost savings are no longer accruing through the existing contract, and

(2) limiting the overall term of the contract to a reasonable timeframe so that the full benefit of marketplace competition can be applied to secure favorable pricing and refresh terms and conditions. I plan to discuss award-term contracting with agencies that have used this technique to get a better of sense of how this tool can be used most effectively.

Increasing share-in-savings contracting. The draft bill would build on authority in the E-Government Act that provides for expanded pilots of share-in-savings contacting for IT. SARA would provide permanent share-in-savings authority and permit use of this tool for any need, as opposed to only IT needs.

I appreciate that the Committee is anxious for the government to take advantage of a tool that has been used only rarely since its creation in the Clinger-Cohen Act as well as to permit its application to any type of purchase where the concept may provide benefit. To help ensure successful use of the recently enacted E-Government pilot authority for IT acquisitions, OMB, among other things, will work to ensure that agencies heed the lessons learned by industry, as identified in a recent report by the General Accounting Office (GAO). Namely, there must be thorough and deliberative planning, as well as management commitment, to identify clear outcomes and measures that are agreed upon by both parties to a share-in-savings contract.

As the Committee considers additional applications of share-in-savings contracting, please be aware that OMB is opposed to any expansion of the authority provided in the E-Government Act to waive full funding of termination costs. Agencies should account fully for the government's obligations when they enter into contracts. Further expansion of share-in-savings should not increase the government's exposure to unfunded contingent liabilities, especially given the government's limited experience with

this tool and the GAO's caution that the government may face challenges identifying favorable opportunities (at least until we gain experience in establishing appropriate baselines). OMB welcomes the opportunity to work with the Committee to further discuss options for facilitating the successful use of share-in-savings.

Telecommuting. The draft bill would include a provision to recognize the use of telecommuting by federal contractors. The Committee's desire to address this issue is certainly understandable. Telecommuting by contractor employees may enable agencies to realize lower contract prices by lowering the costs for contractors doing business with the government. For this reason, I would agree that agency requirements and evaluation criteria should not generally be used as a basis for disqualifying an offeror who seeks to telecommute or for reducing that offeror's score. Of course, there will be instances where telecommuting will either be undesirable or inconsistent with the government's needs. Thus, agencies will need the ability to *either* render an offer ineligible *or* reduce the scoring of an offeror who seeks to telecommute if the requirements cannot be met in this fashion and the determination is documented in writing.

Access to the commercial marketplace

As a third goal, SARA would take several steps to further facilitate access to the capabilities of the marketplace**.** I would like to briefly comment on provisions that would: (a) address use of the commercial marketplace for fighting terrorism and (b) expand application of the FAR's commercial item policies.

Combating terrorism. The ongoing war on terrorism has intensified the need for responsive, results-based contracting. The new flexibilities authorized by the Homeland Security Act, which were enacted with this Committee's proactive efforts, represent a reasonable set of tools to help agencies meet the demands associated with protecting our homeland. The FAR was amended earlier this year to implement the emergency procurement flexibilities. OFPP has prepared supplementary (non-regulatory) guidance, which we plan to issue shortly. We have purposely written the guidance in basic terms to facilitate broad distribution and understanding throughout the acquisition community. Our aim is to reinforce successful and confident application of these tools, generally through *common sense* reminders.

I appreciate the potential need for emergency procurement flexibilities beyond the present sunset date of November 24, 2003 and would support their continued availability as the Committee advocates. However, I would prefer that the authorities remain subject to an appropriate sunset date, as opposed to being made permanent, until we have a better sense of their overall effect in helping agencies meet their missions.

Finally, I favorably note the Committee's intention to allow agencies to engage in transactions other than contracts, grants, or cooperative agreements (so-called "other

transactions" or OTs) for research and development, including prototype efforts for purposes of supporting efforts to combat terrorism. By reducing barriers to commercial firms, OTs can broaden the technology base and foster new relationships and practices within the current supplier base.

Expanding application of FAR Part 12 commercial item policies. I understand that the new bill, like H.R. 3832, will contain provisions to expand application of FAR Part 12, which is designed to reduce barriers between the government and sellers of commercial items. Similar to H.R. 3832, one provision would provide express authority for use of a time-and-materials (T&M) contract or labor-hour (L/H) contract for the procurement of commercial services. However, unlike H.R. 3832, the new bill would limit use of these contract types to services that are "commonly sold to the general public through such contracts." A second provision would eliminate caveats in law that currently require that services be sold in substantial quantities, among other things, in order to be considered eligible for Part 12. A third provision would require an agency to purchase the non-commercial items of a "commercial entity" using the clauses and policies prescribed by Part 12 if at least 90 percent (in dollars) of the sales of the enterprise over the past three business years have been made to private sector entities or under FAR Part 12.

The revised coverage on T&M and L/H contracting is an improvement over that originally proposed in H.R. 3832. However, the latter two provisions, which are unchanged from that set forth in H.R. 3832, continue to raise concerns.

<u>T&M and L/H contracting and the definition of commercial service</u>. Last year, the issue of whether use of T&M or L/H contracts should be authorized under FAR

Part 12 appeared to trigger more public dialogue than any other provision of SARA. Some praised the idea, claiming that T&M and L/H contracting will encourage more commercial firms to compete for government business. They pointed out, among other things, that these contract types minimize pricing risk for contractors and allow parties to reach agreement in an administratively simplified manner. Others, such as the Defense Inspector General (DOD IG), opposed the idea of expanding use of T&M and L/H contracting for commercial item purchases. The DOD IG pointed out that T&M contracts, for example, are susceptible to cost growth because profit is built into the hourly billing rate and contractors have little incentive to control cost or increase labor efficiency. The DOD IG cautioned that T&M contracts require a high degree of surveillance. This admonition is hardly limited to DOD. In a hearing earlier this year, one civilian agency IG, discussing experiences with a T&M contract, reported a seven-fold cost overrun, which increased the bill to taxpayers by hundreds of millions of dollars.

My point is not to scare agencies from using T&M contracting, either as a general matter or for the acquisition of commercial items. Rather, I want to reiterate the very real need for appropriate oversight and safeguards if a T&M contract is otherwise appropriate for use. I believe this message is especially important in the context of using T&M contracts in FAR Part 12, because Part 12 was drafted with the expectation that purchases would be made through arrangements that provide payment in return for tangible results. The FAR drafters gave little thought to the risk involved when using a flexibly-priced contract to buy commercial items. Accordingly, if we are to use T&M and L/H contracts

under Part 12, we must do so in a way that ensures the government's interests are adequately protected.

For this reason, I commend the Committee for proposing to limit use of T&M and L/H contracts to procurements of commercial services that are commonly sold to the general public in this fashion. I strongly agree that the government should not, as a general matter, be taking on levels of risk that a smart commercial business would not undertake.

I would further recommend that the Committee retain current requirements for competitive sales in substantial quantities. As a general matter, even where fixed-price contracts are being used, this caveat continues to play an important role in helping the government to manage and mitigate risks. In the case of a T&M contract in particular, an agency will have the assurance that a contractor's services have been purchased repeatedly in the commercial marketplace to help offset the fact that the agency must bear the risk that the arrangement is simply one for best efforts.

In addition, agencies will need to heed the long-standing warning that has always been coupled with T&M contracting -- i.e., that these contracts be used *only* when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence. When agencies know their requirements and can meet them with commercial items, they need to negotiate fixed-price arrangements that effectively protect the government's business interest, just as a commercial contractor would do. Indeed, I would challenge anyone to point to an example of where a successful commercial company routinely

accepts the risk of T&M or L/H contracts for commercial needs once they can be definitized.

As SARA moves forward, I plan to work with the other FAR Council members to continue to think about what other steps may need to be taken. But, as you can see, I think the Committee has taken an important positive step in enabling the effective use of T&M and L/H contracting under Part 12.

Commercial entities. The new bill, like H.R. 3832, would require an agency to purchase the non-commercial items of a *commercial entity* using the clauses and polices prescribed by Part 12**.** In order to do so, we would need to accept the premise that the government will be protected when it buys non-commercial items (i.e., items that are not sold or even of a type offered or sold in the marketplace) as long as the company has a demonstrated track record in selling commercial items at fair and reasonable prices. Unfortunately, I am unable to find any meaningful protection for the taxpayer in accepting the pricing of a non-commercial item based solely on the company's good track record for an unrelated product or service. For this reason, I urge the Committee to reconsider this proposal.

Conclusion

Mr. Chairman, as you have just heard, the Administration shares many of Committee's desires to strengthen procurement management, better incentivize our contractors, and take greater advantage of the commercial marketplace. While there are some areas of disagreement, I believe that with continued dialogue, we can reach agreement on a significant number of legislative provisions that can serve to further our

joint vision of a results-oriented, market-driven government. I look forward to working with the Committee as we work towards the delivery of better value for agencies and the taxpayer.

This concludes my prepared remarks. I am happy to answer any questions you may have.